



A REPORT  
TO THE  
MONTANA  
LEGISLATURE

FINANCIAL AUDIT

# *Montana State Lottery*

*For the Two Fiscal Years Ended  
June 30, 2012*

FEBRUARY 2013

LEGISLATIVE AUDIT  
DIVISION

12-30

## LEGISLATIVE AUDIT COMMITTEE

### REPRESENTATIVES

RANDY BRODEHL  
[brodehl@centurytel.net](mailto:brodehl@centurytel.net)

VIRGINIA COURT  
[Vjchd52@yahoo.com](mailto:Vjchd52@yahoo.com)

MIKE CUFFE  
[mike@mcuffe.com](mailto:mike@mcuffe.com)

MARY McNALLY  
[mcnallyhd49@gmail.com](mailto:mcnallyhd49@gmail.com)

RYAN OSMUNDSON  
[Ryanosmundson@gmail.com](mailto:Ryanosmundson@gmail.com)

J.P. POMNICHOWSKI  
[pomnicho@montanadsl.net](mailto:pomnicho@montanadsl.net)

### SENATORS

DEE BROWN  
[repdee@yahoo.com](mailto:repdee@yahoo.com)

TAYLOR BROWN  
[taylor@northernbroadcasting.com](mailto:taylor@northernbroadcasting.com)

GREG JERGESON  
[jergeson4senator@yahoo.com](mailto:jergeson4senator@yahoo.com)

CLIFF LARSEN  
[cliff@larsenusa.com](mailto:cliff@larsenusa.com)

FREDRICK (ERIC) MOORE  
[mail@SenatorEricMoore.com](mailto:mail@SenatorEricMoore.com)

MITCH TROPILA, CHAIR  
[tropila@mt.net](mailto:tropila@mt.net)

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## FINANCIAL AUDITS

Financial audits are conducted by the Legislative Audit Division to determine if the financial statements included in this report are presented fairly and the agency has complied with laws and regulations having a direct and material effect on the financial statements. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) licenses.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2011, was issued March 29, 2012. The Single Audit Report for the two fiscal years ended June 30, 2013, will be issued by March 31, 2014. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator  
Office of Budget and Program Planning  
Room 277, State Capitol  
P.O. Box 200802  
Helena, MT 59620-0802

Legislative Audit Division  
Room 160, State Capitol  
P.O. Box 201705  
Helena, MT 59620-1705

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### AUDIT STAFF

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JEANE CARSTENSEN-GARRETT	ALEXA O'DELL
MARIA RUSTEMEYER	KAREN SIMPSON

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# LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor  
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors  
Cindy Jorgenson  
Angus Maciver

February 2013

The Legislative Audit Committee  
of the Montana State Legislature:

This is our financial audit report of the Montana State Lottery (Lottery) for the two fiscal years ended June 30, 2012. This report does not contain any recommendations to the Lottery. Included in this report, beginning on page A-1, is the Independent Auditor's Report followed by the Lottery's financial statements and notes to the financial statements.

The written response to the audit is included on B-1 of the audit report. We thank the Director and her staff for their assistance and cooperation throughout the audit.

Respectfully submitted,

*/s/ Tori Hunthausen*

Tori Hunthausen, CPA  
Legislative Auditor



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## APPOINTED AND ADMINISTRATIVE OFFICIALS

			<u>Term Expires</u>
<b>Montana State Lottery Commission Members</b>	Wilbur Rehmann, Chair	Helena	1/1/2013
	Craig Anderson, Dawson County Sheriff	Glendive	1/1/2013
	Thomas M. Keegan, Attorney at Law	Helena	1/1/2014
	Beth O'Halloran (through January 31, 2013)	Missoula	1/1/2014
	Leo Prigge, CPA	Butte	1/1/2015
<b>Administrative Officials</b>	Angela Wong, Montana State Lottery Director		
	John Tarr, Montana State Lottery Director of Security		
	Armond Sergeant, Financial Services Director		

For additional information concerning the Montana State Lottery, contact:

Armond Sergeant, Financial Services Director  
 2525 N. Montana Ave.  
 Helena, MT 59601  
 (406) 444-5813  
 e-mail: [asergeant@mt.gov](mailto:asergeant@mt.gov)



# MONTANA LEGISLATIVE AUDIT DIVISION

## FINANCIAL AUDIT

### Montana State Lottery

For the Two Fiscal Years Ended June 30, 2012

FEBRUARY 2013

12-30

REPORT SUMMARY

State law requires a minimum of 45 percent of the money paid for tickets or chances be paid out as prize money and net revenue earned be transferred to the General Fund. In fiscal year 2012, the Montana State Lottery transferred approximately \$13 million to the General Fund, which is a \$2.2 million increase from the amount transferred in fiscal year 2011.

### Context

For the last 25 years, Montana has allowed lottery games in which players purchase a chance to win a prize through the Montana State Lottery. A five-member Lottery Commission, whose members are appointed by the Governor, has certain powers and duties in law. State law also provides certain powers and duties to the director of the Montana State Lottery who is also appointed by the Governor.

Section 23-7-410, MCA, states the Legislative Auditor shall conduct or have conducted an annual audit of the Montana State Lottery. This is the third consecutive audit of the Montana State Lottery conducted by the Legislative Auditor; all other audits since the Lottery's inception were performed by private CPA firms through contracts with the Legislative Audit Division. The previous two audits were financial-compliance audits and included six and three recommendations, respectively, to the Montana State Lottery. This audit was a financial audit, which means our work was limited to that necessary to determine if the Montana State Lottery's financial statements are fairly presented for fiscal year 2012, with comparative financial amounts for fiscal year 2011, in conformity with generally accepted

accounting principles and state accounting policy. In addition, we evaluated the three recommendations included in the prior audit.

We determined the Montana State Lottery implemented one recommendation and partially implemented the other two recommendations. The two recommendations that were partially implemented relate to internal controls over financial reporting. We will review and evaluate Lottery's financial reporting controls as part of the next financial-compliance audit of the Lottery.

### Results

This audit report does not include any recommendations to the Montana State Lottery.

Recommendation Concurrence	
Concur	0
Partially Concur	0
Do Not Concur	0
<b>Source: Agency audit response included in final report.</b>	

For a complete copy of the report (12-30) or for further information, contact the Legislative Audit Division at 406-444-3122; e-mail to [lad@mt.gov](mailto:lad@mt.gov); or check the web site at <http://leg.mt.gov/audit>

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# Chapter I – Introduction

## **Introduction**

We performed a financial audit of the Montana State Lottery (Lottery) for the two fiscal years ended June 30, 2012. The objective of our audit was to determine if the Statement of Net Assets; Statement of Revenues, Expenses and Changes in Fund Net Assets; and Statement of Cash Flows for the Lottery are fairly presented, in conformity with generally accepted accounting principles and state accounting policy, for fiscal year 2012, with comparative financial amounts for fiscal year 2011. The objective included:

1. Obtaining an understanding of the Lottery's control systems to the extent necessary to support the audit of the financial statements and, if necessary, make recommendations for improvement in management and internal controls of the Lottery.
2. Determining the Lottery's compliance with laws and regulations having a direct impact on financial statement amounts.
3. Determining the implementation status of the three audit recommendations from the prior audit.

This audit report fulfills the statutory requirement of an annual audit of the Montana State Lottery. This audit was a financial audit, which means our audit work was limited to that necessary to achieve the objective discussed above.

This audit report does not contain any recommendations to the Montana State Lottery. The next audit will be a financial-compliance audit that will include follow-up on the Lottery's internal controls over financial reporting as discussed in the prior audit recommendation section.

## **Background**

The Lottery was approved in November 1986 by a referendum vote of the people of Montana. The general purpose is to allow lottery games in which players purchase from the State, through the administration of the Lottery, a chance to win a prize. A five-member Lottery Commission is provided for in state law. Members of the Commission are appointed by the Governor to four-year staggered terms. The director of the Lottery is also appointed by the Governor. Current games offered by the Lottery include scratch tickets, Powerball, Mega Millions, Montana Cash, Wild Card, Hot Lotto, 10 Spot, EZ Play, Fantasy Football, Fantasy Racing, and Montana Millionaire.

Lottery's operations are accounted for in an enterprise fund type, which means that its operations are financed and operated in a manner similar to private enterprise where

the intent is to provide goods or services to the general public. State law requires a minimum of 45 percent of money paid for ticket and chances be used for prizes and the Lottery transfer its net revenue to the General Fund. The Lottery receives no state funding.

The Lottery is a member of the Multi-State Lottery Association (MUSL), a nonprofit, government-benefit association. It is owned and operated by its member lotteries; each state member lottery sits on the MUSL Board of Directors. Rules and regulations for all member state lotteries are developed by the MUSL board.

### **Prior Audit Recommendations**

The prior audit report for the Montana State Lottery included three recommendations. We determined the Lottery fully implemented one of the recommendations and partially implemented the other two recommendations. The two recommendations not fully implemented relate to internal controls over financial reporting and are discussed in greater detail below.

During the prior audit, we determined the Lottery's internal controls over financial reporting were not adequate; as a result, we made two audit recommendations to the Lottery. The two recommendations addressed improvements needed in knowledge and application of state accounting policy and strengthening their financial statement preparation controls. In the current audit, we found that Lottery has taken some steps to implement the prior audit recommendations, and we identified significantly fewer fiscal year 2012 errors than were identified in the prior two audits. However, the Lottery could enhance its financial reporting system controls through additional documentation. Periodic reviews to ensure significant activity is properly recorded on the accounting system and presented and disclosed in the financial statements and notes would also improve the financial reporting control system. Additional documentation and periodic reviews would help retain accounting and financial reporting knowledge Lottery personnel have gained in recent years. This would mitigate the risks associated with staff turn-over or extended absences and help ensure that Lottery's financial activity is recorded on the accounting records and reported and disclosed on the financial statements in accordance with generally accepted accounting principles.

Based on the progress Lottery has made in regards to their financial reporting system controls, we make no further recommendations to the Lottery at this time. We will review and evaluate Lottery's financial reporting controls as part of the next scheduled financial-compliance audit of the Lottery.

# **Independent Auditor's Report and Montana State Lottery Financial Statements**



## LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor  
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors  
Cindy Jorgenson  
Angus Maciver

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Assets of the Montana State Lottery as of June 30, 2012, and 2011, and the related Statement of Revenues, Expenses and Changes in Fund Net Assets, and Statement of Cash Flows for each of the fiscal years then ended. The information contained in these financial statements is the responsibility of Montana State Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the enterprise fund of the Montana State Lottery and do not purport to, and do not, present fairly the financial position of the state of Montana as of June 30, 2012, and 2011, and the related changes in its financial position or cash flows for each of the two fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Montana State Lottery as of June 30, 2012, and 2011, and its changes in net assets and cash flows for the fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

*/s/ Cindy Jorgenson*

Cindy Jorgenson, CPA  
Deputy Legislative Auditor

January 29, 2013



**MONTANA LOTTERY  
STATEMENT OF NET ASSETS  
JUNE 30, 2012 AND 2011**

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ASSETS:	2012	2011 (restated)
<b>CURRENT ASSETS</b>		
Cash and Cash Equivalents	\$ 3,401,567	\$ 2,717,838
Receivables (Net)	1,845,914	1,825,263
Multi-State Reserve Fund	65,000	50,000
Inventories	382,328	367,625
Securities Lending Collateral	5,584	29,168
Prepaid Expenses	28,949	27,175
	<hr/>	<hr/>
<b>TOTAL CURRENT ASSETS</b>	<b>5,729,342</b>	<b>5,017,069</b>
<b>NONCURRENT ASSETS</b>		
Computer, Furniture & Equipment	2,899,606	2,415,766
Leasehold Improvements	45,448	45,448
Equipment - Work in Process	65,000	669,500
Accumulated Depreciation	(1,057,431)	(725,205)
Investments	43,813	37,214
Multi-State Reserve Fund	1,997,105	1,638,570
	<hr/>	<hr/>
<b>TOTAL NONCURRENT ASSETS</b>	<b>3,993,541</b>	<b>4,081,293</b>
<b>TOTAL ASSETS</b>	<b>\$ 9,722,883</b>	<b>\$ 9,098,362</b>
	<hr/>	<hr/>
<b>LIABILITIES:</b>		
<b>CURRENT LIABILITIES</b>		
Accounts Payable	\$ 511,115	\$ 368,716
Estimated Prize Liability	2,071,903	1,731,441
Transfer Obligations	3,241,941	2,892,772
Liability under Security Lending	5,584	29,168
Deferred Revenue	137,725	131,262
Accrued Compensated Absences	120,213	129,540
Current Portion Long-Term Obligations	72,168	72,168
	<hr/>	<hr/>
<b>TOTAL CURRENT LIABILITIES</b>	<b>6,160,649</b>	<b>5,355,067</b>
<b>NONCURRENT LIABILITIES</b>		
Multi-State Prize Liability	1,542,685	1,525,857
Accrued Compensated Absences	90,678	69,629
Long Term Obligations	198,461	270,629
Other Post Employment Benefits	488,054	395,337
	<hr/>	<hr/>
<b>TOTAL NONCURRENT LIABILITIES</b>	<b>2,319,878</b>	<b>2,261,452</b>
<b>TOTAL LIABILITIES</b>	<b>8,480,527</b>	<b>7,616,519</b>
<b>NET ASSETS</b>		
Invested in Capital Assets, net of related debt	1,681,994	2,062,712
Unrestricted Net Assets	(439,638)	(580,869)
	<hr/>	<hr/>
<b>TOTAL NET ASSETS</b>	<b>1,242,356</b>	<b>1,481,843</b>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b>\$ 9,722,883</b>	<b>\$ 9,098,362</b>
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The accompanying notes are an integral part of these financial statements.

**MONTANA LOTTERY**  
**STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS**  
**FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

	2012	2011
OPERATING REVENUES:		
Scratch Ticket Revenue	\$ 16,527,196	\$ 15,064,556
On Line Ticket Revenue	36,074,640	30,975,226
License, Permits, and Misc	<u>15,464</u>	<u>8,450</u>
Total Operating Revenues	52,617,300	46,048,232
DIRECT GAME COSTS:		
Scratch Ticket Prize Expense	10,307,079	8,990,017
On Line Ticket Prize Expense	18,307,863	15,787,901
Retailer Commissions	3,146,282	2,716,363
Cost of Tickets Sold	885,876	1,059,590
Vendor fees	<u>3,086,206</u>	<u>2,759,777</u>
Total Direct Game Costs	35,733,306	31,313,648
Income Before Operating Expenses	16,883,994	14,734,584
OPERATING EXPENSES:		
Advertising	610,303	638,550
Advertising Production	155,662	249,447
Audit Fees	55,610	36,757
Bad Debts Expense	4,318	382
Communications	130,969	131,321
Contractual Services	91,719	106,444
Depreciation and Amortization	458,598	269,154
Interest	17,809	21,987
Administrative Service Fee	63,348	66,685
Multi-State Dues	49,657	45,530
Public Relations	36,017	34,414
Other Post Employment Benefits	89,199	95,476
Other Expenses	27,743	33,945
Personal Services	1,809,740	1,834,607
Repairs and Maintenance	29,215	18,539
Supplies and Materials	235,208	287,945
Travel	41,806	39,928
Utilities and Rent	<u>161,776</u>	<u>154,956</u>
Total Operating Expense	4,068,697	4,066,067
Operating Income	12,815,297	10,668,517
NONOPERATING REVENUES (EXPENSES):		
Interest Earnings	10,358	8,296
Security Lending Income	1,037	1,292
Security Lending Expense	(204)	(274)
Gain/Loss on Sale of Assets	<u>(5,303)</u>	<u>0</u>
Total Nonoperating Revenues(Expenses)	<u>5,888</u>	<u>9,314</u>
Income Before Operating Transfers	12,821,185	10,677,831
Operating Transfers Out - General Fund	<u>(13,060,672)</u>	<u>(10,820,988)</u>
CHANGE IN NET ASSETS	(239,487)	(143,157)
Total Net Assets, Beginning of Period	<u>1,481,843</u>	<u>1,625,000</u>
TOTAL NET ASSETS, END OF PERIOD	<u>\$ 1,242,356</u>	<u>\$ 1,481,843</u>

The accompanying notes are an integral part of these financial statements.



**MONTANA LOTTERY  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

A-5

	2012	2011
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts for Sales & Services	\$ 52,598,794	\$ 46,002,490
Payments for Goods & Services	(8,677,957)	(8,400,079)
Payments to Employees	(1,798,018)	(1,862,271)
Payments for Prizes	(28,257,652)	(25,313,743)
Net Cash Provided by Operating Activities	<u>13,865,167</u>	<u>10,426,397</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Transfer to Other Funds	(12,711,503)	(10,395,349)
Net Cash Used For Noncapital Financing	<u>(12,711,503)</u>	<u>(10,395,349)</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Acquisition of Fixed Assets	(19,500)	0
Proceeds from Sale of Fixed Assets	8,485	0
Principal & Interest Payment on Leases	(89,977)	(94,155)
Net Cash Used For Capital Financing	<u>(100,992)</u>	<u>(94,155)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Interest and Dividends on Investments	11,191	9,314
Received from (Paid to) MUSL Prize Reserve Fund	(373,535)	(258,184)
Sale (Purchase) of long term investments	(6,599)	34,160
Net Cash Used for Investing Activities	<u>(368,943)</u>	<u>(214,710)</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	683,729	(277,817)
<b>CASH AND CASH EQUIVALENTS, JULY 1</b>	<u>2,717,838</u>	<u>2,995,655</u>
<b>CASH AND CASH EQUIVALENTS, JUNE 30</b>	<u>\$ 3,401,567</u>	<u>\$ 2,717,838</u>
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities</b>		
Operating Income	\$ 12,815,297	\$ 10,668,517
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities		
Depreciation	458,598	269,154
Interest Expense	17,809	21,987
Change in Assets and Liabilities:		
Decr (Incr) in Account Receivable	(20,651)	(38,865)
Decr (Incr) in Inventories	23,584	160,748
Decr (Incr) in Collateral securities on loan	(14,703)	16,448
Decr (Incr) in Prepaid expenses	(1,774)	63,322
Incr (Decr) in Accounts Payable	142,399	(243,958)
Incr (Decr) in Lottery Prizes Payable	357,290	(535,825)
Incr (Decr) in Liability for securities on loan	(23,584)	(16,448)
Incr (Decr) in Deferred Revenue	6,463	(6,495)
Incr (Decr) in Other Post Employment Benefits	92,717	95,476
Incr (Decr) in Compensated Absences Payable	11,722	(27,664)
Total Adjustments	<u>1,049,870</u>	<u>(242,120)</u>
Net Cash Provided by Operating Activities	<u>\$ 13,865,167</u>	<u>\$ 10,426,397</u>

The accompanying notes are an integral part of these financial statements.

**MONTANA LOTTERY**  
Notes to the Financial Statements  
June 30, 2012

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Reporting Entity.

The Montana Lottery, established under the provisions of Section 23-7-101, Montana Code Annotated (MCA), was approved by the Montana electorate through Legislative Referendum No. 100 on November 4, 1986.

Montana's first lottery tickets went on sale June 24, 1987.

The Montana Lottery is operated by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set the ticket price, number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games in conjunction with other lottery states and countries, and prepare financial reports. The Montana Lottery is attached to the Montana Department of Administration for administrative purposes.

The Montana Lottery is included as an enterprise fund in the State of Montana's Comprehensive Annual Financial Report. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Montana Lottery's financial statements as a reporting entity.

Basis of Presentation. The Montana Lottery reports its financial activity in accordance with generally accepted accounting principles (GAAP) as prescribed in pronouncements of the Governmental Accounting Standards Board (GASB).

Enterprise Fund. The Montana Lottery is classified as an Enterprise Fund of the Proprietary Fund Type. Enterprise Funds account for operations: a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate.

Basis of Accounting. The Montana Lottery's financial statements are prepared using the accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and become measurable; expenses are recognized in the period incurred, if measurable.

Property and equipment. Property and equipment are recorded at cost. Donated property and equipment are recorded at their estimated fair market value at the date of donation. Ordinary maintenance and repairs are charged to operations as incurred; major renewals and betterments are capitalized. Upon disposition or retirement of property and equipment, the cost and related accumulated depreciation or amortization are removed from the accounts. Gain or loss on disposal is reflected in non-operating revenues and expenses. Depreciation and amortization are calculated on a straight-line basis over estimated useful lives of three to ten years. The Lottery conforms to the State of Montana capitalization threshold for capitalizing property and equipment as well as buildings and building/land improvements. The threshold for capitalizing property and equipment is \$5,000 and the threshold for capitalizing buildings/land improvements is \$25,000.

Revenue Recognition. Lottery scratch ticket sales are recorded as revenue based on the time the retailer activates the pack of tickets for sale. In accordance with an established policy, retailers may return unsold tickets to the Lottery for credit. Sales are decreased by an allowance for estimated ticket returns.

Ticket sales for lotto games Powerball, Wild Card, Montana Cash, Hot Lotto, Montana Millionaire, Mega Millions, and 10 Spot are recorded as revenue based on drawings. Tickets sold in advance for future drawings are recorded as deferred revenue until such time as the tickets become valid for the most current drawing.

Ticket sales for Fantasy Sports games are based upon MCA 23-4-302 and an interagency agreement between the Lottery and the Board of Horse Racing.

Classification of Revenues. The Lottery has classified its revenues as either operating or non-operating according to the following criteria:

Operating revenues – include activities that have characteristics of exchange transactions, including (1) ticket sales, net of returns, and (2) retailer license fees and administrative fees in relation to selling lottery tickets.

Non-Operating revenues – include activities that have the characteristics of non-exchange transactions, such as gifts and other revenue sources that are defined as non-operating revenues by GASB No. 9, “Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting,” and GASB No. 34, “Basic Financial Statements and Management Discussion and Analysis for State and Local Governments.” Types of revenue sources that fall into this classification are investment income, and gain or loss on disposition of assets.

Free Tickets. Some Montana Lottery scratch games award free tickets as prizes. Net lottery ticket revenue does not include the value of free tickets given away and free plays won. The face value of these free ticket prizes distributed for the year ended June 30, 2012 was \$529,367.

Promotional Credits. The Lottery issues promotional credits to retailers to be used to distribute free tickets to players. The tickets are distributed as part of a promotion run by the retailer, e.g., "Ask for the Sale" or second chance drawings. The Lottery also directly distributes scratch tickets for promotional purposes at trade shows, for media give-aways, and during new game introductions. The tickets distributed as a result of promotional credits are reflected as a reduction in revenue. The related prize expense and ticket cost for all promotions are reclassified as an advertising expense. For the year ended June 30, 2012 promotional credits resulted in a revenue reduction of approximately \$21,545 and an expense reclassification of approximately \$16,784.

Prizes. Expenses for scratch prizes are recorded based on the predetermined prize structure for each game. Expenses for lotto prizes are recorded based on the predetermined prize structure for each individual game. No prize expense is recorded for free tickets distributed.

Unclaimed Prizes. Prizes for the lotto games must be claimed within six months after the appropriate draw date. Prizes for scratch games must be claimed within six months of the announced end of each game. The unclaimed prize amounts for the Montana Lottery lotto games are taken as a reduction in the Lottery Prizes Payable liability and the Prize Expense and are transferred to the State of Montana General Fund as a portion of the quarterly transfer. The amount of unclaimed prizes for all Montana Lottery games is represented in the table below.

	Quarter Ended 6/30/12	Quarter Ended 6/30/11	Year To Date 6/30/12	Year To Date 6/30/11
Lotto	\$124,768	\$122,792	\$484,389	\$ 694,034
Scratch	\$260,931	\$306,181	\$454,014	\$ 683,781
<b>TOTALS</b>	\$385,699	\$428,973	\$938,403	\$1,377,815

Reclassification and Restatement. In order to make certain prior year amounts compare to current year presentation on the Statement of Net Assets, \$50,000 of the Multi-State Reserve Fund was reclassified as a current asset for fiscal year ending 2011. This amount represents the amount of the Powerball Unreserved Account that is expected to be converted to cash and collected from the Multi-State Lottery Association (MUSL) during the next fiscal year.

## 2. SUMMARY OF ACCOUNTS

Cash and Cash Equivalents. Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investment pool; cash on deposit in a revolving account with a non-state financial institution; and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily.

Cash and cash equivalents consist of the following:

	June 30,	
	<u>2012</u>	<u>2011</u>
Short-term investment pool	\$2,658,107	\$2,154,658
Cash on deposit with State Treasurer	723,045	553,130
Cash in revolving deposit account	20,215	10,000
Petty Cash & Cash on Hand	200	50
<b>TOTALS</b>	<b>\$3,401,567</b>	<b>\$2,717,838</b>

The bank balance of the revolving deposit account, not including outstanding deposits or checks, was \$77,393 as of June 30, 2012 and was covered by federal depository insurance. The carrying amount reported in the balance sheet for cash and cash equivalents approximates the fair market value.

Receivables. Receivables include \$2,047,346, representing amounts due the Lottery for tickets purchased by retailers. Receivables also include \$943 for interest income due from the Montana Board of Investments short-term investment pool. An allowance for ticket returns is included in the receivables amount. This allowance represents a reduction in receivables as of June 30, 2012, for estimated ticket returns. This is an estimate based on returns received to date, as well as an estimate of tickets unsold by retailers for games that have a public sale end date prior to July 1, 2012. The allowance for ticket returns is \$214,835 as of June 30, 2012. The return of vendor fees related to the allowance for returns is \$12,460.

Inventories. Inventories consist of merchandise and supplies inventories. Merchandise inventory includes scratch tickets valued at \$259,126 that are stored in the warehouse, at retailers prior to being activated by the retailer, and with the marketing representatives. These ticket inventories are recorded at cost using the specific identification method and maintained on a perpetual inventory system. Tickets are charged to cost of tickets sold upon activation or after game end.

Supplies inventories include ticket dispensers, premiums and point-of-sale materials. At year end, supplies inventories totaled \$123,202. These inventories are also recorded at cost using the specific identification method.

Other Current Assets. Other current assets include the following:

	June 30,	
	<u>2012</u>	<u>2011</u>
Prepaid Expenses	<u>\$28,949</u>	<u>\$27,175</u>

The prepaid expense amount consists of \$14,075 for booth fees for upcoming summer fairs, and \$14,874 for prepaid commissions and vendor fees related to deferred revenue.

Property and Equipment. A summary of property and equipment for the Lottery is as follows:

	June 30,			June 30,
	<u>2011</u>	<u>Additions</u>	<u>Deletions</u>	<u>2012</u>
Leasehold Improvements	\$ 45,448	\$ -	\$ -	\$ 45,448
Furniture & Equipment	\$ 2,415,766	\$ 624,000	\$ (140,160)	\$ 2,899,606
Accumulated Depreciation	\$ (725,205)	\$ (458,598)	\$ 126,372	\$ (1,057,431)

Estimated Prize Liability. The estimated prize liability represents the Lottery's estimate of prizes payable related to games in process at year-end based on the predetermined prize structure of each outstanding game.

Obligation to Transfer Funds. The Lottery is required to transfer its net revenue to the Montana State General Fund. This change was enacted through the passage of SB83 by the 1995 Legislature and signed into law by Governor Racicot in April 1995. The transfer obligations outstanding at June 30, 2012 and 2011 were \$3,241,941 and \$2,892,772, respectively.

Compensated Absences. State employees earn vacation leave ranging from 15 to 24 days per year depending on the individual's years of service. Vacation leave may be accumulated not to exceed two times the maximum number of days earned annually. With no limit on accumulation, sick leave is earned at 12 days per year. Upon retirement or termination, an employee is paid 100% for unused vacation and 25% for unused sick leave. The Lottery's liability for compensated absences is detailed below.

<u>Balance</u>	<u>Net Leave</u>	<u>Balance</u>
<u>June 30, 2011</u>	<u>Earned/(Used)</u>	<u>June 30, 2012</u>
\$199,169	\$11,722	\$210,891

OPEB (Other Post Employment Benefits) Implicit Rate Subsidy LT. Effective for Fiscal Year End 08, GASB Statement 45 and the reporting requirements for the “implied rate subsidy” required the State of Montana to book substantial liabilities. The liability is a result of the state’s requirement to allow retired employees to remain in the health insurance plan after retirement. This results in an implicit rate subsidy since retirees pay the same amount as active employees. “Actuaries Northwest” prepared the report for the State of Montana to calculate the Annual Required Contribution under the Governmental Accounting Standards Board (GASB). The allocation is made based on the fiscal year’s benefits expense and the number of full time employees for an agency.

The Lottery’s OPEB obligations for 2012 and 2011 are as follows:

<b><u>Year ended June 30,</u></b>	<b><u>2012</u></b>	<b><u>2011</u></b>
Annual Required Contribution	\$ 92,717	\$ 95,476
Adjustment to annual required contributions	-	-
Annual OPEB cost	\$ 92,717	\$ 95,476
Contributions made	-	-
Increase to net OPEB obligation	\$ 92,717	\$ 95,476
Net OPEB obligation – beginning of year	\$ 395,337	\$ 299,861
Net OPEB obligation – end of year	<u>\$ 488,054</u>	<u>\$ 395,337</u>

Commissions. Section 23-7-301(10), MCA, provides retailers a commission on scratch and lotto tickets or chances sold. The Lottery Commission established this commission at 5% of the face value of scratch tickets activated by the retailers and the face value of lotto tickets sold. Section 23-4-302 (5)(b)(i), MCA, establishes a 3.99% commission for the face value of Fantasy Sports tickets sold. In addition retailers can earn bonus commissions on tickets sold based on incremental sales of scratch tickets. For the quarter and twelve months ended June 30, 2012 retailers earned bonus commissions of \$134,966 and \$488,641, respectively. For the quarter and twelve months ended June 30, 2012 total commissions were \$781,789 and \$3,146,282, respectively.

### 3. PAYMENTS TO OTHER STATE AGENCIES

The Lottery receives a variety of services, supplies, and materials from other state agencies. These services and materials are detailed below for the fiscal year ended June 30, 2012:

Insurance	\$ 8,543
Warrant Writing Services	698
Payroll Services	4,453
Audit Fees	55,610
Computer Fees	48,108
Printing	932
State Accounting System Support	2,534
Supplies & Materials	11,350
Mail Processing Fees	8,013
Telecommunications	17,545
Vehicle Rental Fees	62
Administrative Service Fees	63,348
Other	<u>1,749</u>
<b>TOTAL</b>	<b>\$ <u>222,945</u></b>

### 4. PRIZES

Paid Prizes. Section 23-7-402, MCA states, "A minimum of 45% of the money paid for tickets or chances must be paid as prize money". Prize expense is recorded based on the predetermined prize structure percentage for each game less unclaimed prizes. For the year ended June 30, 2012, the prize expense of \$28,614,942 is 54.40% of net Lottery ticket revenue of \$52,601,836. For the year ended June 30, 2011, the prize expense of \$24,777,918 was 53.82% of net Lottery ticket revenue of \$46,039,782

### 5. TRANSFER TO STATE GENERAL FUND

Section 23-7-402(3), MCA, states "That part of all gross revenue not used for payment of prizes, commissions, and operating expenses, together with the interest earned on the gross revenue while the gross revenue is in the enterprise fund, is net revenue. Net revenue must be transferred quarterly from the enterprise fund established by 23-7-401 to the State General Fund." For the year ended June 30, 2012, the net revenue payable to the State General Fund totaled \$3,241,941.



## 6. MULTI-STATE LOTTERY

In November 1989 the Montana State Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. Powerball, Wild Card, Hot Lotto, and Mega Millions are the games jointly operated by the members, in which Montana presently participates. Each lottery participating in MUSL is represented on the Board of Directors.

The Multi-State Lottery Reserve Fund with a balance of \$2,062,105 and \$1,688,570 as of June 30, 2012, and 2011, respectively, is comprised of several reserve accounts, which are maintained by the Multi-State Lottery Association (MUSL). A portion of the Powerball Unreserved Account is classified as a current asset which represents an amount expected to be converted into cash and collected from MUSL within the next fiscal year. The balance of these reserve accounts and investment category is as follows:

	<u>June 30, 2012</u>		
	US <u>Treasury</u>	Federal <u>Agencies</u>	<u>Total</u>
Powerball Prize Reserve Account	\$ 433,871	\$ 212,058	\$ 645,929
Powerball Set Prize Reserve Account	105,003	102,226	207,229
Powerball Unreserved Account	243,972	275,448	519,420
Wild Card Prize Reserved Account	145,102	73,854	218,956
Hot Lotto Set Prize Reserve Account	211,485	143,355	354,840
Mega Millions Prize Reserve Account	<u>58,641</u>	<u>57,090</u>	<u>115,731</u>
Total Reserves	<u>\$1,198,074</u>	<u>\$ 864,031</u>	2,062,105
Less Current Portion			<u>(65,000)</u>
<b>Non Current Reserves</b>			<b>\$ <u>1,997,105</u></b>

	<u>June 30, 2011</u>		
	US <u>Treasury</u>	Federal <u>Agencies</u>	<u>Total</u>
Powerball Prize Reserve Account	\$ 412,996	\$ 269,530	\$ 682,526
Powerball Set Prize Reserve Account	103,249	67,383	170,632
Powerball Unreserved Account	98,457	64,255	162,712
Wild Card Prize Reserved Account	160,479	104,731	265,210
Hot Lotto Set Prize Reserve Account	216,079	141,018	357,097
Mega Millions Prize Reserve Account	<u>30,493</u>	<u>19,900</u>	<u>50,393</u>
Total Reserves	<u>\$1,021,753</u>	<u>\$ 666,817</u>	1,688,570
Less Current Portion			<u>(50,000)</u>
<b>Non Current Reserves</b>			<b>\$ <u>1,638,570</u></b>

The Powerball Prize Reserve Account is to be used only in the event of an unanticipated prize claim. It is an insurance fund intended to protect the member lotteries against the liability that could result from a system failure at one of the member lotteries. All money paid to this fund would be returned to the Lottery one year after the Lottery leaves the Powerball game, assuming that no unanticipated prize claims have been paid.

The Powerball Set Prize Reserve Account is used to fund prize payments for current drawings. Since the Powerball game has fixed prizes, it is often necessary to draw from this reserve to fund payment of prizes at the fixed amount. This account would be returned to the Lottery upon withdrawal from the Powerball game.

The Lottery contributes to these reserve funds through the 50% set aside for prizes. In addition the Lottery was required to contribute for its portion of the reserve funds accumulated since the start of the Powerball game. Payments made to this fund are considered a portion of prize expense associated with the game.

The Powerball Unreserved Account is a separate account used by a participating Lottery to have MUSL hold funds due to the Lottery. Balances in this account are created when any MUSL jackpot expires and goes unclaimed. Each Lottery is then refunded its pro rata share of the jackpot based on sales during the accumulation of that specific jackpot. This money is then invested in U.S. Treasury securities until withdrawn. Interest earned on the Lottery's share of the fund is added to the Unreserved Account on a quarterly basis. The amount in the Unreserved Account has limited uses and are set and approved by the Board with the stipulation that requests to use the funds are accompanied by certification from the requesting Board Member that the payment is made in conformance with state or jurisdiction law and is related to a MUSL activity. During the fiscal year ended 2012, the Lottery received two refunds for unclaimed jackpots; one for \$185,854 for an unclaimed Powerball jackpot, and another for \$439,281 for an unclaimed Hot Lotto jackpot. The Lottery also received \$870 in interest and had \$49,657 withdrawn for annual MUSL dues. During fiscal year ended 2011, the Lottery received \$1,417 in interest and had \$46,030 withdrawn for annual MUSL dues.

The Wild Card Reserve Account is to be used in the event of an unanticipated prize claim on the Wild Card game. This account is also administered by MUSL and would be returned to the Lottery one year after the Wild Card Product Group of Idaho, Montana, South Dakota, and North Dakota is disbanded. The Lottery contributes to this account through the 55% set aside for prizes. Payments made to this fund are considered a portion of prize expense related to the Wild Card game.

The Hot Lotto Set Prize Reserve Account is administered by MUSL and is to be used only in the event of unanticipated prize claims. Like other MUSL games the reserve amount would be returned to the Lottery one year after withdrawal from the Hot Lotto game. The Lottery contributes to the reserve through the 50% set aside for prizes. Payments made to the reserve are considered a portion of the prize expense related to the game.

The Mega Millions Prize Reserve Account is to be used only in the event of an unanticipated prize claim. It is an insurance fund intended to protect the member lotteries against the liability that could result from a system failure at one of the member lotteries. All money paid to this fund would be returned to the Lottery one year after the Lottery leaves the Mega Millions game, assuming that no unanticipated prize claims have been paid. The Lottery contributes to the reserve through the 51.5% set aside for prizes. Payments made to the reserve are considered a portion of the prize expense related to the game.

## **7. GAMES**

Currently, the Montana Lottery games are scratch ticket games, seven lotto games referred to as Powerball, Montana Ca\$h, Wild Card, Hot Lotto, Mega Millions, 10 Spot, EZ Play, and Montana Millionaire, a limited edition lottery game. The lottery is facilitating Fantasy Sports Games on behalf of the Board of Horse Racing. Currently the Lottery is selling the Montana Sports Action Fantasy Football and the Racing games.

Scratch ticket games provide players the opportunity to win instantly by scratching latex covering to reveal a prize.

The Powerball game allows players the chance to win a minimum pari-mutuel jackpot of approximately \$40 million. If there are multiple winning tickets, the pari-mutuel jackpot is equally divided among the winners. Players must match all 6 numbers to win the jackpot. For any drawing, if no ticket matches 6 out of 6 numbers, the jackpot rolls over to the next drawing to create a progressive jackpot. Drawings are held twice weekly on Wednesday and Saturday nights. In March 2001, the Lottery added Power Play to the Powerball game. Choosing Power Play will increase player winnings at set prize levels.

The Montana Ca\$h game allows players the chance to win a minimum pari-mutuel jackpot of \$20,000. Players select 5 numbers from a field of 37 and must match at least 3 out of 5 to win a prize. Matching 3 of 5 wins \$5 and 4 of 5 wins \$200. The drawing is conducted twice weekly on Wednesday and Saturday nights. If no ticket matches all 5 numbers, the jackpot rolls over to the next drawing to create a progressive jackpot.

The Wild Card game allows players the chance to win a pari-mutuel jackpot, with a guaranteed minimum of \$100,000. Players select 5 numbers from a field of 31 plus one of 16 face cards and must match all 5 numbers and the wild card to win the jackpot; players win prizes from \$1 to \$5,000 for matching less than all 5 numbers and/or the wild card. Drawings are held twice weekly on Wednesday and Saturday nights. If no ticket matches all 5 numbers and the wild card, the jackpot rolls over to the next drawing to create a progressive jackpot.

Hot Lotto allows players the chance to win a pari-mutuel jackpot with a guaranteed minimum of \$1 million. Players choose 5 numbers from a field of 39 plus 1 Hot Ball number from a field of 19; the first 5 numbers and the Hot Ball must be matched to win the jackpot. Players can win prizes ranging from \$2 to \$10,000 by matching less than all 5 numbers and/or the Hot Ball. If no ticket wins the jackpot, it rolls over to the next drawing to create a progressive jackpot. Drawings are held twice weekly on Wednesday and Saturday nights. In January 2008, the Lottery added the Sizzler option to the Hot Lotto game. For an additional bet, the Sizzler option provides non-jackpot winners the chance to multiply their prize amount by three.

Mega Millions is a multi-state game that allows players to win a minimum pari-mutuel jackpot starting at \$12 million. Mega Millions went on sale March 1, 2010 in Montana. To win the jackpot, players must match all six numbers drawn; other prizes range from \$2 to \$250,000. Drawings are held each Tuesday and Friday. Mega Millions has a Megaplier option which multiplies non-jackpot prizes by two, three, or four. The Megaplier options costs \$1 extra per play.

10 Spot which went on sale February 1, 2010, is a Montana-only, twice daily game. Players select ten numbers from one through eighty. The Lottery draws twenty numbers, and players win by matching ten, nine, eight, seven, six, five, or none of the numbers drawn. Prizes range from \$2 to \$25,000.

Montana Sports Action is a product line introduced by the Lottery in August 2008 on behalf of the Board of Horse Racing. Montana Sports Action Fantasy Football was the first game within the Fantasy Sports Games to begin. Players choose five eligible offensive players and a defensive unit from the official roster of professional football players and teams, to create their own team. The players then choose a play amount (\$5, \$10, \$20, \$50, or \$100) which determines the shares the player is eligible to win should their team have one of the three highest point totals for the week.

After completion of each week's professional football games, points are assigned to football players and defensive units based on their performance to determine the Lottery players' team's performance. Prizes paid must be 74% of sales for the week. How much the player wins is determined by their team's points and their share (\$5 per share). Ticket sales are allowed each week of the professional football season beginning Tuesday morning for that week's games with no advanced purchasing allowed.

Fantasy Racing was introduced in February 2009, and follows the NASCAR® Sprint Cup Series. Fantasy Racing teams are created by selecting a driver from the top ten-ranked drivers for the week; three drivers ranked from ten through 34; and one driver ranked 35 or above. The sixth element in a player's Fantasy Racing team is the number of yellow-flag cautions the player believes might occur in that week's race. Players also choose the number of shares they wish to buy (\$5, \$10, \$20, \$50 or \$100). Like Fantasy Football, the number of shares determines the amount of the prize each winning ticket will win. After each Sprint Cup race, points are assigned to each driver's performance, and teams with the top three point totals win. Ticket sales begin each week on Monday.

Montana Millionaire began on October 1, 2007, and was sold until December 31, 2007. Montana Millionaire is a seasonal raffle-type game offering a million-dollar top prize. Tickets are sold sequentially. The 2007 game offered 150,000 tickets selling for \$20 each. Since 2007, the Lottery has offered Montana Millionaire every winter. In Fiscal Year 2012, Montana Millionaire sold from November 1 through December 31, with a drawing on New Years' Day 2012. An early bird drawing for \$10,000 was offered on Thanksgiving weekend to stimulate early sales. There were also 200 \$50 instant winners. The \$20 game sold through midnight December 31, 2011. On January 1, 2012, one \$1 million prize was awarded, along with four \$100,000 prizes and four \$10,000.

## **8. COMMITMENTS - GAMING SUPPLIER CONTRACTS**

Scratch Tickets. On June 27, 2008 the Montana Lottery Commission approved the award of a five-year contract with Scientific Games International (SGI) for the provision of scratch tickets. The contract is for five years with the option for two additional one-year renewals. The contract contains specifications regarding ticket design, printing, game ownership, inspection, and prize structure.

SGI, as the vendor, provided a performance bond covering the contract term and an errors and omissions policy covering an ultimate net loss of \$3,000,000. The Lottery may terminate this contract by providing proper notification to Scientific Games.

On-line Services. On October 11, 2005, the Lottery signed a seven-year contract with Intralot, Inc. of Duluth, GA to provide an on-line gaming system and the associated services beginning March 31, 2006. The contract requires Intralot to provide new terminals to all retailers with the associated software and communications. Payment under the contract is based on 5.8% of net weekly Lottery sales of lotto and scratch games. On August 18, 2008 an addendum was signed to provide services for the Fantasy Sports games at 3% of net weekly Lottery sales up to \$2,999,999 of Montana Sports Action games. The contract currently has a termination date of March 30, 2016.

## **9. LOTTO\*AMERICA/POWERBALL/TRI-WEST JACKPOT PRIZES**

Jackpot prizes awarded in the Lotto\*America/POWERBALL and TRI-WEST LOTTO games are funded through the purchase of U.S. Treasury Zero-Coupon Bonds purchased in the name of the Montana Lottery by MUSL. MUSL will cash the bonds each year as they mature and will wire the funds to the Lottery for payment to winners on the Anniversary date of the win.

On July 6, 1994 the Montana Lottery awarded its first Tri-West Lotto jackpot prize totaling \$700,565. The first annual payment of \$35,000 was made on July 26, 1994.

On July 22, 1995 the Montana Lottery awarded its first Powerball jackpot prize totaling \$31,401,655.99. The first payment of \$1,571,655.99 was made on August 8, 1995. On April 5, 1997 the Lottery awarded a second Powerball jackpot prize totaling \$11,000,000. The first annual payment of \$550,000 was awarded on April 18, 1997.

As of June 30, 2012, the combined total of future prize payments funded through the purchase of U.S. Treasury Zero-Coupon Bonds for Powerball and Tri-West Lotto winners is \$6,980,000. Total annual payments due as of June 30, 2012 are as follows:

<u>FYE</u>	
2013	2,155,000
2014	2,155,000
2015	2,120,000
2016	550,000
	<u>\$ 6,980,000</u>

## 10. LEASES/INSTALLMENT PURCHASES PAYABLE

Rent. The Montana Lottery leases its office, administrative and warehouse facilities under a lease agreement that is effective September 2007 through August 2017. The monthly lease payment is \$11,432 through August 2012. The base rate will increase 3% annually.

Capital Lease. The Lottery has contracted with its vendor to lease equipment for the remaining life of its contract with them. Obligations under this capital lease/installment purchase at June 30, 2012 are as follows:

<u>FYE</u>	
2013	85,827
2014	81,677
2015	77,528
2016	<u>55,423</u>
Total Minimum Payments	300,455
Less: Interest	<u>( 29,826)</u>
Present value of Minimum Payments	<u>\$ 270,629</u>

## 11. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the State of Montana implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*. The Lottery participates in two investment pools: the Multi-State Lottery Association (MUSL) reserve accounts and the State of Montana's Short Term Investment Pool (STIP). There are four types of risk that must be disclosed. These risks are defined below, followed by their applicability to each of the investment pools.

Multi-State Lottery Association The MUSL investment policy for prize reserve and unreserved funds states that permitted investments "include direct obligations of the United States government, perfected repurchase agreements, and obligations issued or guaranteed as to payment of principal and interest by agencies or instrumentalities of the United States government, and mutual funds of approved investments".

Short-term Investment Pool All short-term funds are held in the State's Short Term Investment Pool (STIP) administered by the Board of Investments (BOI). STIP is an external 2a-7 like pool.



**Credit risk** is defined as the risk that an issuer of an investment will not fulfill its obligation, i.e., not make timely principal and interest payments. The STIP securities have credit risk as measured by major credit rating services, however, the pool is not rated. The Lottery does not have a policy regarding credit risk

Per MUSL, for 2012 the prize reserves held on behalf of the Montana Lottery are invested in the Montana Winners Trust and include an average of 58% in securities held as obligations of the U.S. Government and are not considered to have credit risk. The other 42% of the prize reserves are invested in Federal Agencies and have an AA+ credit quality rating. The Lottery does not have any authority or a policy regarding the investment portfolios.

**Custodial credit risk** is the risk that the Lottery would not be able to recover the value of the investment or collateral securities that are in the possession of an outside party in the event of the failure of that party. Custodial credit risk does not apply to STIP because it is a 2a-7 like pool.

The MUSL prize reserves are held in the Montana Winners Trust using policies set forth by the MUSL board regarding policies for the type of securities, as well as the custody, trading and the use of proceeds of the securities. The Lottery does not have any authority or a policy regarding the investment portfolios.

**Concentration of credit** is the risk of loss attributed to the magnitude of a government's investment in a single issuer. Because STIP is a pooled investment, this risk does not apply. Because the MUSL reserves are also a pooled investment, this risk does not apply to them either.

**Interest rate risk** is the risk that changes in interest rates will adversely affect the fair value of an investment. Interest rate risk does not apply to STIP because it is a 2a-7 like pool. The Lottery does not have any authority or a policy regarding the investment portfolios.

The MUSL prize reserves are invested through the Montana Winners Trust in the Morgan Stanley Government Portfolio Funds with daily liquidity and therefore have no interest rate risk. The MUSL board's investment policy limits the individual security and the portfolio's maturity. As of June 30, 2012, the duration for the U.S. Government Treasury securities was a blended rate of .49 years.



## **12. EMPLOYEE RETIREMENT PLAN**

All Lottery employees hired are, initially, members of the Public Employees Retirement System – Defined Benefit Retirement Plan (PERS-DBRP). PERS-DBRP is a defined benefit cost sharing, multiple-employer public retirement system established on July 1, 1945 and governed by Title 19, chapters 2 & 3 of the Montana Code Annotated. This plan provides retirement, disability and death benefits to substantially all public employees and their beneficiaries not covered by another public plan.

New hires have a 12 month window during which they may choose to transfer to the Public Employees Retirement System – Defined Contribution Retirement Plan (PERS-DCRP) or remain in the current PERS-DBRP. Members may not be members of both plans. The choice is irrevocable. Members of the DCRP direct their contributions and a portion of their employer's contributions among the offered investment options. The remaining portion of their employer's contributions is used to reduce the Plan Choice Rate unfunded actuarial liability, to fund the long-term disability benefits to participants of the DCRP, and to fund an employee education program.



MONTANA STATE  
LOTTERY

LOTTERY RESPONSE





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FEB 22 2013

LEGISLATIVE AUDIT DIV.

February 22, 2013

Ms. Tori Hunthausen, Legislative Auditor  
Legislative Audit Division  
Room 135, State Capitol  
Helena, MT 59620

Dear Ms. Hunthausen;

I would like to thank the Legislative Audit staff for their assistance and work performed on the Montana Lottery Financial Audit for the two fiscal years ending June 30, 2012. We appreciate the services your staff provide in reviewing the Lottery's procedures, internal controls, accounting practices, and the accuracy of the financial statements. We feel this audit was productive and instrumental in continually improving the financial reporting for the agency.

I am available to answer questions or provide further information that you or the Legislative Audit Committee may require.

Sincerely,

Angela Wong  
Lottery Director

